



STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY

State Capitol
Nashville, Tennessee 37243-0260
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John G. Morgan
Comptroller

April 19, 2004

Memorandum

TO: The Honorable Phil Bredesen, Governor

The Honorable Douglas Henry, Jr., Chairman
Senate Finance, Ways, & Means Committee

The Honorable Tommy Head, Chairman
House Finance, Ways, & Means Committee

FROM: John Morgan, Comptroller of the Treasury
Riley Darnell, Secretary of State
Dale Sims, State Treasurer
M.D. Goetz, Jr., Commissioner
Department of Finance & Administration

SUBJECT: Revenue Estimates for FY 2003-04 and FY 2004-05

The State Funding Board met on April 15 and 19, 2004, to hear updated presentations on, and to engage in discussions about, the State's near-term economic outlook for the fiscal years 2003-04 and 2004-05. During this meeting, the Board heard economic testimony from Dr. William Fox of The University of Tennessee, Dr. Albert DePrince of Middle Tennessee State University, Dr. John Gnuschke and Dr. Richard Evans of the University of Memphis, Mr. Jim White of the Fiscal Review Committee, and Mr. Reid Linn of the State Department of Revenue. The Board was also briefed on the monthly revenue report on state tax collections for the month of March. The state tax revenue estimates provided by each of the presenters are summarized in the two attachments to this memorandum (schedule 1 for fiscal year 2003-04 and schedule 2 for fiscal year 2004-05).

The consensus is that the economy is experiencing a small recovery with some job growth. Improved capital investment appears to be centered in information processing and other technology equipment. It was noted that not all jobs are equal, and neither are the related salaries. The loss in manufacturing jobs in Tennessee has been offset by low-wage jobs. The economic growth currently experienced by Tennessee is a result in improved productivity, and not in job creation. It was observed that the areas of the State least hit by job losses were those areas with citizens with higher levels of education. It was agreed that an educated workforce is essential for a strong Tennessee economy.

The presenters also discussed factors which could weaken the projected growth. There was much discussion over Iraq and the continued US presence there as well as the impact of global terrorism. The Board also considered the impact of the weakness of the dollar and the increase in health care costs and in oil and gas prices.

Based on the testimony received and the Board discussions, the Board determined to adjust the consensus revenue ranges for fiscal year 2003-04 and to maintain the ranges for fiscal year 2004-05, as previously established in December 2003. The following table summarizes these revised Estimates:

	FY 2003-04		FY 2004-05	
	<u>Low</u>	<u>High</u>	<u>Low</u>	<u>High</u>
Total State Taxes	5.50%	6.05%	3.6%	4.35%
General Fund Only	6.60%	7.35%	3.85%	4.6%

The Board believes these consensus revenue growth ranges to be reasonable and appropriate for use in state budgeting.

In December 2003, Ms. Rebecca Paul, the Chief Executive Officer and President of the Tennessee Education Lottery Corporation, and Mr. Steve Adams, the Chief Operating Officer, confirmed the speculative nature of any ranges as to lottery revenues developed at that time, but anticipated by spring 2004 the availability of information necessary for revenue estimation. At the April 15, 2004 meeting, the State Funding Board received a presentation from Ms. Paul and Mr. Andy Davis, Chief Financial and Technology Officer. Mr. Adams was also present. They advised of the significant variables and assumptions used in their estimates:

- Ongoing start-up costs
- Introduction of additional of instant games
- Payment of instant games prizes
- Advertising
- Retailer compensation plan

Memorandum
page 3
April 19, 2004

They reported that:

- Ticket sales began January 20, 2004.
- Initially, approximately 3,500 retailers participated; currently there are approximately 4,000 retailers participating.
- The lottery started with four instant ticket games, and 15 more games have been added.
- The first computer-based game started March 1, 2004.
- Powerball is scheduled to start April 19, 2004.
- For the first quarter (ending March 31, 2004) gross ticket sales were \$231,580,000.
- The first deposit to the Education Account was made April 15, 2004 in the amount of \$63,774,000; additional quarterly payments will be made on the 15th of July, October, and January.

They then presented estimates, qualified as being conservative, of \$105 million for fiscal year 2003-04 and of \$200 million for fiscal year 2004-05 for the net proceeds of lottery revenues to be deposited in the Lottery for Education Account, to be used for the various statutory purposes. Attached is a copy of the report dated April 15, 2004 presented by Ms. Paul and Mr. Davis.

After consideration of the above information and the prior legislative fiscal note estimation of \$195 million to \$215 million in net lottery proceeds for fiscal year 2004-05, the Board determined to concur with the conservative lottery ranges presented by the Lottery Corporation, consistent with the fiscal note.

Each of us stands ready to discuss this further at your convenience.

Attachments 3

cc The Honorable John S. Wilder
The Honorable Jimmy Naifeh

COMPARISON OF ESTIMATED STATE TAX REVENUE FOR
FISCAL YEAR 2003-2004

Schedule 1

(Accrual - Basis Estimates)

2003-2004															
DEPARTMENT OF REVENUE	2002-2003		% CHANGE	2004-05	% CHANGE		% CHANGE		% CHANGE		% CHANGE		% CHANGE		% CHANGE
SOURCE OF REVENUE	ACTUAL	BUDGETED	OVER 02-03	BUDGET DOCUMENT	OVER 02-03	DR. FOX	OVER 02-03	FISCAL REVIEW	OVER 02-03	DR. DePRINCE	OVER 02-03	DR. EVANS	OVER 02-03	REVENUE DEPT.	OVER 02-03
	COLLECTIONS	ESTIMATE	ACTUAL	ESTIMATE	ACTUAL	ESTIMATE	ACTUAL	ESTIMATE	ACTUAL	ESTIMATE	ACTUAL	ESTIMATE	ACTUAL	ESTIMATE	ACTUAL
Sales and use Tax	\$5,458,227,200	\$ 5,619,900,000	2.96%	\$ 5,770,900,000	5.73%	\$ 5,770,000,000	5.71%	\$ 5,787,298,000	6.03%	\$ 5,771,000,000	5.73%	\$ 5,828,300,000	6.78%	\$ 5,769,300,000	5.70%
Gasoline Tax	602,346,800	588,500,000	-2.30%	606,900,000	0.76%	606,900,000	0.76%	602,080,000	-0.04%	594,100,000	-1.37%	601,700,000	-0.11%	605,400,000	0.51%
Motor Fuel Tax	155,409,200	165,100,000	6.24%	161,000,000	3.60%	165,000,000	6.17%	165,351,000	6.40%	167,900,000	8.04%	164,400,000	5.79%	159,900,000	2.89%
Gasoline Inspection Tax	60,858,000	64,700,000 *	6.31%	62,000,000	1.88%	62,000,000	1.88%	62,003,000	1.88%	57,400,000 *	-5.68%	62,000,000	1.88%	61,700,000	1.38%
Motor Vehicle Registration Tax	225,033,600	240,800,000	7.01%	237,000,000	5.32%	230,000,000	2.21%	234,169,000	4.06%	238,400,000	5.94%	236,900,000	5.27%	234,300,000	4.12%
Income Tax	115,852,100	121,100,000	4.53%	120,000,000	3.58%	135,000,000	16.53%	130,344,000	12.51%	128,900,000	11.26%	119,400,000	3.06%	104,300,000	-9.97%
Privilege Tax - Less Earmarked Portion	216,535,800	217,600,000	0.49%	240,000,000	10.84%	250,000,000	15.45%	238,923,000	10.34%	239,200,000 (1)	10.47%	229,100,000 (1)	5.80%	237,800,000	9.82%
Gross Receipts Tax - TVA	198,502,100	204,600,000	3.07%	202,700,000	2.11%	202,400,000	1.96%	202,046,000	1.79%	204,600,000 **	3.07%	204,600,000 **	3.07%	202,400,000	1.96%
Gross Receipts Tax - Other	18,134,400	19,400,000	6.98%	19,000,000	4.77%	18,000,000	-0.74%	17,455,000	-3.75%	20,100,000	10.84%	12,000,000	-33.83%	16,400,000	-9.56%
Beer Tax	17,063,700	18,000,000 *	5.49%	18,100,000	6.07%	17,700,000	3.73%	17,596,000	3.12%	16,000,000 *	-6.23%	18,000,000	5.49%	17,800,000	4.32%
Alcoholic Beverage Tax	34,059,200	35,000,000 *	2.76%	36,000,000	5.70%	36,000,000	5.70%	36,392,000	6.85%	31,000,000 *	-8.98%	36,600,000	7.46%	35,900,000	5.40%
Franchise & Excise Taxes	1,071,699,700	1,068,600,000	-0.29%	1,068,600,000	-0.29%	1,080,000,000	0.77%	1,098,900,000	2.54%	1,199,700,000	11.94%	1,167,800,000	8.97%	1,093,100,000	2.00%
Inheritance and Estate Tax	83,148,300	75,000,000 *	-9.80%	85,000,000	2.23%	90,000,000	8.24%	96,217,000	15.72%	66,500,000 *	-20.02%	119,700,000	43.96%	90,200,000	8.48%
Tobacco Tax	114,716,900	118,400,000 *	3.21%	115,600,000	0.77%	116,600,000	1.64%	119,598,000	4.25%	105,000,000 *	-8.47%	122,100,000	6.44%	120,500,000	5.04%
Motor Vehicle Title Fees	10,978,300	11,100,000 *	1.11%	11,100,000	1.11%	11,100,000	1.11%	11,249,000	2.47%	9,800,000 *	-10.73%	11,400,000	3.84%	11,300,000	2.93%
Mixed Drink Tax	38,422,300	39,900,000 *	3.85%	40,400,000	5.15%	40,400,000	5.15%	41,037,000	6.81%	35,400,000 *	-7.87%	40,700,000	5.93%	39,900,000	3.85%
Business Tax	40,481,500	96,400,000 *	138.13%	92,000,000	127.26%	92,000,000	127.26%	95,000,000	134.68%	85,500,000 *	111.21%	96,400,000	138.13%	96,400,000	138.13%
Severance Tax	1,073,900	1,100,000 *	2.43%	1,100,000	2.43%	1,100,000	2.43%	1,100,000	2.43%	1,000,000 *	-6.88%	1,100,000	2.43%	1,100,000	2.43%
Coin Operated Amusement Tax	441,500	3,500,000 *	NA	1,300,000	NA	1,500,000	NA	1,000,000	NA	3,100,000 *	NA	3,500,000	NA	400,000	NA
TOTAL DEPARTMENT OF REVENUE	\$ 8,462,984,500	\$ 8,708,700,000	2.90%	\$ 8,888,700,000	5.03%	\$ 8,925,700,000	5.47%	\$ 8,957,758,000	5.85%	\$ 8,974,600,000	6.05%	\$ 9,075,700,000	7.24%	\$ 8,898,100,000	5.14%
GENERAL FUND ONLY (2)	\$ 6,962,149,700	\$ 7,222,800,000	3.74%	\$ 7,386,200,000	6.09%	\$ 7,421,900,000	6.60%	\$ 7,455,558,000	7.09%	\$ 7,480,400,000	7.44%	\$ 7,573,200,000	8.78%	\$ 7,405,100,000	6.36%
Growth over FY 04 Budgeted Estimate:															
Total				\$180,000,000		\$217,000,000		\$249,058,000		\$265,900,000		\$367,000,000		\$189,400,000	
General Fund				\$163,400,000		\$199,100,000		\$232,758,000		\$257,600,000		\$350,400,000		\$182,300,000	
Growth over FY 05 Budget Document Estimate:															
Total						\$37,000,000		\$69,058,000		\$85,900,000		\$187,000,000		\$9,400,000	
General Fund						\$35,700,000		\$69,358,000		\$94,200,000		\$187,000,000		\$18,900,000	
SELECTED TAXES	ACTUAL	BUDGETED	%	BUDGET DOC.	%	DR. FOX	%	FISCAL REVIEW	%	DR. DePRINCE	%	DR. EVANS	%	REVENUE DEPT.	%
SALES AND USE TAX	\$ 5,458,227,200	\$ 5,619,900,000	2.96%	\$ 5,770,900,000	5.73%	\$ 5,770,000,000	5.71%	\$ 5,787,298,000	6.03%	\$ 5,771,000,000	5.73%	\$ 5,828,300,000	6.78%	\$ 5,769,300,000	5.70%
FRANCHISE AND EXCISE TAXES	1,071,699,700	1,068,600,000	-0.29%	1,068,600,000	-0.29%	1,080,000,000	0.77%	1,098,900,000	2.54%	1,199,700,000	11.94%	1,167,800,000	8.97%	1,093,100,000	2.00%
INCOME TAX	115,852,100	121,100,000	4.53%	120,000,000	3.58%	135,000,000	16.53%	130,344,000	12.51%	128,900,000	11.26%	119,400,000	3.06%	104,300,000	-9.97%
ALL OTHER TAXES	1,817,205,500	1,899,100,000	4.51%	1,929,200,000	6.16%	1,940,700,000	6.80%	1,941,216,000	6.82%	2,003,900,000	10.27%	2,079,600,000	14.44%	1,931,400,000	6.28%

(1) Privilege Tax estimates are reduced by \$32,000,000 in 2003-2004 for the earmarked portion of the tax.

(2) F&A calculated the General Fund distribution for all presenters.

* F&A distributed taxes for Dr. DePrince based on ratios for budgeted collections for 2003-2004.

** F&A distributed the Gross Receipts Taxes for Dr. DePrince and Dr. Evans based on anticipated TVA collections in 2003-2004.

COMPARISON OF ESTIMATED STATE TAX REVENUE FOR
FISCAL YEAR 2004-2005

(Accrual - Basis Estimates)

Schedule 2

2004-2005												
DEPARTMENT OF REVENUE	2004-05	% CHANGE		% CHANGE		% CHANGE		% CHANGE		% CHANGE		% CHANGE
SOURCE OF REVENUE	BUDGET DOCUMENT	OVER 03-04	DR. FOX	OVER 03-04	FISCAL REVIEW	OVER 03-04	DR. DePRINCE	OVER 03-04	DR. EVANS	OVER 03-04	REVENUE DEPT.	OVER 03-04
	ESTIMATE	ESTIMATE	ESTIMATE	ESTIMATE	ESTIMATE	ESTIMATE	ESTIMATE	ESTIMATE	ESTIMATE	ESTIMATE	ESTIMATE	ESTIMATE
Sales and use Tax	\$ 6,059,400,000	5.00%	\$ 6,101,800,000	5.75%	\$ 6,088,238,000	5.20%	\$ 6,057,800,000	4.97%	\$ 5,970,000,000	2.43%	\$ 5,994,400,000	3.90%
Gasoline Tax	617,600,000	1.76%	617,600,000	1.76%	611,111,000	1.50%	605,600,000	1.94%	614,700,000	2.16%	611,400,000	0.99%
Motor Fuel Tax	167,400,000	3.98%	171,600,000	4.00%	169,485,000	2.50%	172,800,000	2.92%	163,900,000	-0.30%	163,400,000	2.19%
Gasoline Inspection Tax	63,700,000	2.74%	63,700,000	2.74%	63,553,000	2.50%	59,100,000 *	2.96%	63,700,000	2.74%	62,900,000	1.94%
Motor Vehicle Registration Tax	247,700,000	4.51%	240,400,000	4.52%	243,536,000	4.00%	246,300,000	3.31%	247,400,000	4.43%	239,900,000	2.39%
Income Tax	126,000,000	5.00%	141,800,000	5.04%	136,861,000	5.00%	134,800,000	4.58%	128,400,000	7.54%	104,400,000	0.10%
Privilege Tax - Less Earmarked Portion	244,800,000	2.00%	255,000,000	2.00%	248,480,000	4.00%	255,200,000 (1)	6.69%	252,200,000 (1)	10.08%	243,200,000	2.27%
Gross Receipts Tax - TVA	204,700,000	0.99%	204,400,000	0.99%	206,087,000	2.00%	204,600,000 **	0.00%	204,600,000 **	0.00%	205,600,000	1.58%
Gross Receipts Tax - Other	23,000,000	21.05%	23,000,000	27.78%	18,066,000	3.50%	23,500,000	16.92%	16,800,000	40.00%	16,700,000	1.83%
Beer Tax	18,500,000	2.21%	18,100,000	2.26%	17,948,000	2.00%	16,400,000 *	2.50%	18,500,000	2.78%	18,400,000	3.37%
Alcoholic Beverage Tax	36,900,000	2.50%	36,900,000	2.50%	37,302,000	2.50%	32,000,000 *	3.23%	38,300,000	4.64%	36,600,000	1.95%
Franchise & Excise Taxes	1,090,000,000	2.00%	1,101,600,000	2.00%	1,110,237,000	1.03%	1,243,500,000	3.65%	1,262,500,000	8.11%	1,109,500,000	1.50%
Inheritance and Estate Tax	75,000,000	-11.76%	85,000,000	-5.56%	86,595,000	-10.00%	68,500,000 *	3.01%	130,800,000	9.27%	90,000,000	-0.22%
Tobacco Tax	115,000,000	-0.52%	116,000,000	-0.51%	119,598,000	0.00%	108,100,000 *	2.95%	125,300,000	2.62%	119,900,000	-0.50%
Motor Vehicle Title Fees	11,300,000	1.80%	11,300,000	1.80%	11,474,000	2.00%	10,100,000 *	3.06%	11,900,000	4.39%	11,400,000	0.88%
Mixed Drink Tax	42,000,000	3.96%	42,000,000	3.96%	42,596,000	3.80%	36,400,000 *	2.82%	43,700,000	7.37%	42,800,000	7.27%
Business Tax	97,000,000	5.43%	97,000,000	5.43%	97,850,000	3.00%	88,000,000 *	2.92%	96,400,000	0.00%	96,600,000	0.21%
Severance Tax	1,100,000	0.00%	1,100,000	0.00%	1,100,000	0.00%	1,000,000 *	0.00%	1,100,000	0.00%	1,000,000	-9.09%
Coin Operated Amusement Tax	1,300,000	0.00%	1,500,000	0.00%	1,000,000	0.00%	3,200,000 *	3.23%	3,500,000	0.00%	400,000	0.00%
TOTAL DEPARTMENT OF REVENUE	\$ 9,242,400,000	3.98%	\$ 9,329,800,000	4.53%	\$ 9,311,117,000	3.94%	\$ 9,366,900,000	4.37%	\$ 9,393,700,000	3.50%	\$ 9,168,500,000	3.04%
GENERAL FUND ONLY (2)	\$ 7,684,500,000	4.04%	\$ 7,768,800,000	4.67%	\$ 7,757,217,000	4.05%	\$ 7,821,400,000	4.56%	\$ 7,865,200,000	3.86%	\$ 7,655,200,000	3.38%

Growth over FY 05 Budget Document Estimate:

Total	\$87,400,000	\$68,717,000	\$124,500,000	\$151,300,000	-\$73,900,000
General Fund	\$84,300,000	\$72,717,000	\$136,900,000	\$180,700,000	-\$29,300,000

SELECTED TAXES	BUDGET DOC.	%	DR. FOX	%	FISCAL REVIEW	%	DR. DePRINCE	%	DR. EVANS	%	REVENUE DEPT.	%
SALES AND USE TAX	\$ 6,059,400,000	5.00%	\$ 6,101,800,000	5.75%	\$ 6,088,238,000	5.20%	\$ 6,057,800,000	4.97%	\$ 5,970,000,000	2.43%	\$ 5,994,400,000	3.90%
FRANCHISE AND EXCISE TAXES	1,090,000,000	2.00%	1,101,600,000	2.00%	1,110,237,000	1.03%	1,243,500,000	3.65%	1,262,500,000	8.11%	1,109,500,000	1.50%
INCOME TAX	126,000,000	5.00%	141,800,000	5.04%	136,861,000	5.00%	134,800,000	4.58%	128,400,000	7.54%	104,400,000	0.10%
ALL OTHER TAXES	1,967,000,000	1.96%	1,984,600,000	2.26%	1,975,781,000	1.78%	2,065,600,000	3.08%	2,161,200,000	3.92%	1,960,200,000	1.49%

(1) Privilege Tax estimates are reduced by \$32,000,000 in 2004-2005 for the earmarked portion of the tax.

(2) F&A calculated the General Fund distribution for all presenters.

* F&A distributed taxes for Dr. DePrince based on ratios for budgeted collections for 2003-2004.

** F&A distributed the Gross Receipts Taxes for Dr. DePrince and Dr. Evans based on anticipated TVA collections in 2003-2004.

TENNESSEE EDUCATION LOTTERY CORPORATION
FUNDING BOARD PRESENTATION
April 15, 2004

ESTIMATION OF TOTAL AND NET PROCEEDS FOR
FISCAL YEARS ENDED JUNE 30, 2004 AND JUNE 30, 2005

TENNESSEE EDUCATION LOTTERY CORPORATION
ESTIMATION OF TOTAL AND NET PROCEEDS FOR
FISCAL YEARS ENDED JUNE 30, 2004 AND JUNE 30, 2005

Pursuant to Section 4-51-111, Subsection (c) (1) of the Tennessee Education Lottery Implementation Law, the funding board shall establish a projected revenue range for net proceeds for the remainder of the current fiscal year (through June 30, 2004) and the next succeeding year (July 1 to June 30, 2005). The section also suggests unusual fluctuations in proceeds should be considered, in addition to having the ability to obtain information from those having expertise and experience in projecting revenue from the sale of lottery tickets.

Current Status:

The lottery began ticket sales on January 20, 2004, with a statewide network of approximately 3,500 retailers. The current retailer network is approximately 4,000 retailers.

Sales began with the introduction of four (4) instant ticket games. Subsequently, we have introduced an additional 15 instant games, averaging two games every two weeks.

On March 1, 2004, we introduced our first computer-based game, CASH 3, where the winning numbers are drawn daily. We recently announced the introduction of our second computer-based game, Powerball, scheduled for launch on April 19, 2004, whereby winning numbers will be drawn twice a week on Wednesday and Saturday.

Our first quarter since the start of ticket sales ended on March 31, 2004. The results of the quarter exceeded our expectations in terms of sales and the number of retailers selling our products. Following are some financial highlights as of the end of the quarter:

Gross Ticket Sales	\$ 231,580,000
Total Lottery Proceeds	\$ 210,507,000
Due to Education Account	\$ 63,774,000
Return %	30.3 %
Due to After School Account	\$ 1,165,000
Prize Expense %	55.3 %
Retailer Commissions	\$ 15,052,000
Vendor Fee %	2.4 %
Non-Direct Expenses %	4.7 %

Effective April 15, we will transfer \$63,774,000 to the Lottery for Education Account for the quarter ending March 31, 2004.

Funds due to the After School Account are scheduled for transfer at the end of the current fiscal year (June 30, 2004) in accordance with the statutory requirements.

The success of the first quarter was the result of the combined efforts of our retailers, vendors and employees working together to ensure the effective launch of our lottery products. We will continue this partnership effort as we move forward into the next quarter and next fiscal year.

As we move forward, we must continue to evaluate the potential impact of some significant variables and assumptions that can impact estimated proceeds.

Significant Variables and Assumptions to Impact Estimated Proceeds

Start-up Costs – The lottery continues to incur additional administrative expenses due to start-up activities. Most of the costs are related to the build-out of the permanent office space at the headquarter location, as well as game launch activities associated with launching of the new computer-based games. These costs must be funded through initial proceeds of the corporation, thus reducing net proceeds for the fiscal year ending June 30, 2004.

Introduction of Instant Games – The lottery plans to continue introduction of two instant games every two weeks. This strategy is important to attract new players and keep current players interested since less “sampling” will occur as experienced in the early weeks of the lottery. Instant ticket sales are averaging \$15 million per week over the most recent 4-week period, but are trending down at approximately 3% per week over the last 6 weeks. Based on this trend, we conservatively estimate instant ticket sales to trend as low as \$9 million a week by June 30, 2004. For fiscal year 2005, we have conservatively estimated weekly sales to stabilize at an average of \$10 million a week.

Instant Games Prize Payout – The lottery currently is managing its prize payout percentage for instant games scheduled to be introduced through June 30, 2004 to approximately 58% of instant ticket proceeds, which are net of free tickets available as prizes. At this time, we anticipate this prize payout percentage to remain stable into fiscal year 2005.

Introduction of Computer-based Games – As discussed earlier, two computer-based games will be on sale in the marketplace by June 30, 2004.

CASH 3, a daily game, is currently averaging approximately \$1.6 million, but is trending down at approximately 7% a week. Based on this trend, we conservatively estimate CASH 3 sales to trend as low as \$1 million a week by June 30, 2004. For fiscal year 2005, we have conservatively estimated weekly sales to stabilize at an average of \$1 million a week.

Powerball, a multi-state jackpot game, is scheduled for launch on April 19, 2004. Based on the average jackpots experienced in calendar year 2003, as provided by the Multi-state Lottery Association (MUSL), it is expected the Tennessee lottery will conservatively average approximately \$1.9 million a week of ticket sales in this game for the fiscal year ended June 30, 2004. For fiscal year 2005, we have estimated revenues based on the same assumption as fiscal year 2004, conservatively averaging \$1.9 million a week in sales.

The computer-based games' prize expense is estimated at 50% of sales. The actual prize payout will fluctuate due to the fixed prize amounts available at many of the prize levels in the CASH 3 and the Powerball game matrixes.

Product and Corporate Positioning (Advertising) – A key component of the success of the lottery continues to be the advertising of the products and the programs that will benefit from the lottery proceeds. The ability to promote the product and the beneficiary of the proceeds is very important to the acceptance of the lottery by Tennessee residents. Both brand and beneficiary advertising is scheduled to occur for the fiscal year ending June 30, 2004.

Per Capita Analysis – Generally, per capita analysis is used within the industry to measure the success of a lottery in terms of sales and net proceeds. In using such measurements, several factors must be considered in determining estimated ranges of sales and proceeds. These include the following:

- a. **The products available to the public.** Varying types and number of instant and online products results in varying sales and proceeds results.
- b. **The maturity of the lottery.** Even though population base may be similar, the experience of the player impacts product sales.
- c. **Other related play opportunities.** Lotteries or other gaming venues within close proximity to the state impact the success of the lottery.
- d. **Population base.** Per capita generally uses permanent residents, with no consideration for transient persons, and their propensity to purchase tickets.
- e. **Number of retail locations selling your product.** Generally, the more locations available to sell our product result in more sales on a per capita basis since we are able to reach more of the residents of the state.

As of the date of this report, any per capita comparisons would be premature, due to the lack of historical data available regarding the Tennessee Lottery sales, products and retailer base.

Retailer Compensation Plan – Under the statute, retailers are to be compensated no less than 6.5% for sale of lottery tickets, with no compensation for cashing winning ticket prizes. Therefore, retailers will not recognize any economic value in cashing of tickets, which may impact repeat sales to the player.

Additionally, due to several major corporate-based retailers' decision to pay prizes above certain limits (\$20 to \$50) in money orders or business checks, the repeat sales opportunity is lost at the retailer location. We can not measure the impact on sales due to this decision, but we believe it will have a long-term effect.

SUMMARY:

Based on the above noted current year results, and the significant variables and assumptions, we are conservatively estimating lottery proceeds for the following fiscal years as follows:

Fiscal Year Ending June 30, 2004	\$105 Million
Fiscal Year Ending June 30, 2005	\$200 Million

Additionally, we are estimating the unclaimed funds available for the After School Account as follows:

Fiscal Year Ending June 30, 2004	\$2.1 Million
Fiscal Year Ending June 30, 2005	\$3.5 Million

This estimate is based on a 2% estimate of prizes determined as unclaimed, with 50% of that amount allocated to the After School Account and 50% allocated to future prize payouts.

Attached is a report titled "Tennessee Education Lottery Corporation – Estimation of Total and Net Lottery Proceeds for Fiscal Years 2004 and 2005", which provides additional details related to lottery operations.

Tennessee Education Lottery Corporation

**Estimation of Total and Net Lottery Proceeds
for Fiscal Years 2004 and 2005**

**Tennessee Education Lottery Corporation
Estimation of Total and Net Proceeds for
Fiscal Years 2004 and 2005**

	Actual Through 03/31/04	4/1/2004 to 6/30/2004 Estimate	Fiscal Year 2004 Estimate	Fiscal Year 2005 Estimate
Revenues				
Total Sales	\$ 231,580,000	\$ 175,217,000	\$ 406,797,000	\$ 692,642,000
Avg weekly sales	\$ 22,838,000	\$ 13,478,000	\$ 17,580,000	\$ 13,320,000
Total Proceeds	\$ 210,507,000	\$ 163,342,000	\$ 373,849,000	\$ 646,227,000
Due to Education Account	\$ 63,774,000	\$ 41,278,000	\$ 105,052,000	\$ 199,777,000
% Return	30.3%	25.3%	28.1%	30.9%
Due to the After School Account	\$ 1,165,000	\$ 959,000	\$ 2,124,000	\$ 3,490,000
Direct Expenses (As a % of Total Proceeds)				
Prize Winnings	55.3%	58.7%	56.8%	54.1%
Retailer Commissions (As a % of Gross Sales)	6.5%	6.5%	6.5%	6.5%
Vendor Fees	2.4%	2.2%	2.3%	2.2%
Non-Direct Expenses (As a % of Total Proceeds)				
Advertising	1.6%	1.8%	1.7%	2.4%
Other Gaming	0.1%	1.5%	0.7%	1.0%
Operating & Other	3.0%	3.6%	3.3%	2.6%

Tennessee Education Lottery Corporation
Estimation of Total and Net Proceeds for
Fiscal Years 2004 and 2005

	Actual Through 03/31/04	4/1/2004 - 6/30/2004 Estimate	Fiscal Year 2004 Estimate	Fiscal Year 2005 Estimate
SALES				
Gross Instant Ticket Sales	\$ 223,742,000	\$ 139,671,000	\$ 363,413,000	\$ 521,428,000
On-Line Games	\$ 7,838,000	\$ 35,546,000	\$ 43,384,000	\$ 171,214,000
Total Sales	\$ 231,580,000	\$ 175,217,000	\$ 406,797,000	\$ 692,642,000
Less: Instant Tickets Provided as f	\$ (21,609,000)	\$ (12,915,000)	\$ (34,524,000)	\$ (49,536,000)
Net Ticket Sales	\$ 209,971,000	\$ 162,302,000	\$ 372,273,000	\$ 643,106,000
Other Revenue	\$ 536,000	\$ 1,040,000	\$ 1,576,000	\$ 3,121,000
TOTAL PROCEEDS	\$ 210,507,000	\$ 163,342,000	\$ 373,849,000	\$ 646,227,000
DIRECT EXPENSES				
Prize Winnings	\$ 116,507,000	\$ 95,941,000	\$ 212,448,000	\$ 349,305,000
Retailer Commissions	\$ 15,052,000	\$ 11,390,000	\$ 26,442,000	\$ 45,022,000
Vendor Fees	\$ 5,117,000	\$ 3,604,000	\$ 8,721,000	\$ 13,914,000
Total Direct Expense	\$ 136,676,000	\$ 110,935,000	\$ 247,611,000	\$ 408,241,000
NON-DIRECT EXPENSE				
Advertising	\$ 3,458,000	\$ 2,901,000	\$ 6,359,000	\$ 15,293,000
Other Gaming Expenses	\$ 293,000	\$ 2,383,000	\$ 2,676,000	\$ 6,313,000
Operating & Other Expenses	\$ 6,306,000	\$ 5,845,000	\$ 12,151,000	\$ 16,603,000
Total Non-Direct Expenses	\$ 10,057,000	\$ 11,129,000	\$ 21,186,000	\$ 38,209,000
TOTAL EXPENSES	\$ 146,733,000	\$ 122,064,000	\$ 268,797,000	\$ 446,450,000
Net Proceeds	\$ 63,774,000	\$ 41,278,000	\$ 105,052,000	\$ 199,777,000
Proceeds Available for Transfer	\$ 63,774,000	\$ 41,278,000	\$ 105,052,000	\$ 199,777,000
% of Total Proceeds	30.3%	25.3%	28.1%	30.9%

Tennessee Education Lottery Corporation
Estimate of Total and Net Proceeds for
Fiscal Years 2004 and 2005

	Actual Through 03/31/04	4/1/2004 - 6/30/2004 Estimate	Fiscal Year 2004 Estimate	Fiscal Year 2005 Estimate
Other Revenue				
Interest Income	\$ 67,000	\$ 121,000	\$ 188,000	\$ 360,000
Service Charges for Retailers	\$ 215,000	\$ 905,000	\$ 1,120,000	\$ 2,719,000
Retailer Application Fees	\$ 252,000	\$ 10,000	\$ 262,000	\$ 30,000
Non-Sufficient Funds Fees	\$ -	\$ 2,000	\$ 2,000	\$ 6,000
Miscellaneous Revenue	\$ 2,000	\$ 2,000	\$ 4,000	\$ 6,000
Total Other Revenue	\$ 536,000	\$ 1,040,000	\$ 1,576,000	\$ 3,121,000

Tennessee Education Lottery Corporation
Estimate of Total and Net Proceeds for Fiscal Years 2004 and 2005

Category	Actual Through 03/31/04	4/1/2004 6/30/2004 Estimate	Fiscal Year 2004 Estimate	Fiscal Year 2005 Estimate
Advertising Expenses	\$ 3,458,000	\$ 2,901,000	\$ 6,359,000	\$ 15,293,000
Other Gaming Expenses	293,000	\$ 2,383,000	\$ 2,676,000	\$ 6,313,000
Operating & Other Expenses	6,246,000	\$ 5,905,000	\$ 12,151,000	\$ 16,603,000
Total Non-Direct Expenses	<u>\$ 9,997,000</u>	<u>\$ 11,189,000</u>	<u>\$ 21,186,000</u>	<u>\$ 38,209,000</u>